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Business and Economic Conditions

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General Business Conditions

THE business observers who have been looking for the recession to bottom out around this time have found much in recent news to encourage them. Arrival of spring weather brought out customers at department stores and auto dealers, and ordering by business and government has also picked up. Business investment plans reported in March indicate that the decline in plant and equipment expenditures may be halted and even reversed during the second half of this year. Industrial production and personal income nearly held their own in February, while housing starts rose for a second month. Employment increased slightly though unemployment held around 6.8 per cent of the labor force.

Some of the improvement in the last few weeks may be a natural reaction after the unusually bad weather early this year, but the revival in buying interest points to something more basic. A key item among the encouraging reports was the increase in new orders received by durable goods manufacturers during February. The gap between shipments and new orders virtually disappeared. Part of the rise in orders was due to stepped-up defense contracts with aircraft and instrument firms, but demand for steel and other basic materials also picked up a little. This encourages the hope that the stringent inventory controls of the past year have done their work, that stocks of purchased materials have been cut to a practical working minimum, and that the way has been cleared for any gain in consumption to set off buying all along the line.

These are all signs of a probable "bottoming out." Solid statistical confirmation must await later figures but the prospect is encouraging. It is still far from clear, of course, whether the economy will turn up promptly as in 1958, or will bump along the bottom for several months as in 1954. It is even less apparent whether the recovery will be vigorous and sustained, or mild and incomplete.

Production Bottoming Out

Industrial activity in February held at nearly the same level as in January, and preliminary reports indicate little further change in March. The Federal Reserve index of industrial production (seasonally adjusted, 1957 = 100) stood at 102.0 in February, compared with 102.4 in January. Output of steel, television sets, and some appliances increased, but offsetting declines were registered in autos, furniture, and building materials. Automobile output was still being cut back in March, but an upsurge in sales, trimming dealers' stocks below one million cars, has led to an increase of 18 per cent in the daily production rate scheduled for April. It would appear that weather had much to do with the sales setback in early 1961, and industry officials now talk hopefully of a good spring season.

Steel mills, among the earliest to feel the impact of inventory cutbacks, have also led the rest of the economy on the upswing. New orders

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exceeded shipments in both December and January (the latest months published) and order backlogs reportedly have been strengthened further in February and March despite lagging demand from the automobile industry. Steel output, at a 69 million tons a year rate in December, ran in March at the equivalent of 83 million tons.

If industrial activity touched bottom in February or March, the recession will indeed have been one of the mildest on record. Over all, the dip in gross national product may have been only about one per cent. Industrial production decreased 7.1 per cent through February from the business cycle peak reached last May — about as long a decline as in previous postwar recessions, but not so deep. The contraction through February was smaller than the 10.2 per cent decline in 1953-54 and decidedly less sharp than the 14.1 per cent drop in 1957-58. In 1958 the recovery was prompt and sharp. In 1954, on the contrary, there was a long, relatively flat bottom, persisting for over half the year.

A comparison of movements in the book value of business inventories also shows that the current decline has been more gradual than in the two preceding recessions. The liquidation of manufacturers' stocks tapered off early this year, while retailers were making their first sizable cuts in inventories. In the past, upturns in industrial production and retail sales have usually occurred before inventory reduction has fully run its course. Thus, it would not be unprecedented for inventory liquidation to persist through midyear even though production and sales revive earlier.

Sustained Capital Spending

In a survey taken in January and February and released in March, businessmen reported plans to spend $34.6 billion on plant and equipment during 1961. Although this represents a decline of 3 per cent from the 1960 level, it is encouraging on several counts. The decline is smaller than most observers had anticipated; despite the recession, there has been little deterioration in investment spending plans since last October when a McGraw-Hill survey also showed an anticipated 3 per cent decline from 1960 to 1961.

In addition, these figures point to the possibility of an upturn in the latter part of the year in this vital sector of the economy. Capital expenditures in the first quarter of 1961 were estimated at a seasonally adjusted annual rate of $34.4 billion and outlays in the second quarter are scheduled at a $33.8 billion rate. Thus, if the year as a whole is to average out to the $34.6 billion level reported in the same survey, a somewhat higher rate of spending will be required in the second half. So far, the cutbacks in investment in this recession appear to be following the gradual 11 per cent decline which occurred in 1953-55 much more closely than the 22 per cent cut which followed the 1955-57 capital spending boom.

The Employment Problem

The rise of unemployment in this recession beyond 5 million persons or 6.8 per cent of the labor force has led the Administration to propose a number of relief measures. As was done in the 1958 recession, President Kennedy has secured legislation to help finance a temporary extension of unemployment compensation from the general standard of 26 weeks to a maximum of 39 weeks. The cost is figured at about $1 billion, to be recovered by added taxes on employers. He has also proposed temporary federal contributions toward the cost of relief aids for children of needy jobless parents, and optional retirement at age 62 for men under the old-age pension system. At the same time, the President has strongly advocated enactment of depressed-areas legislation which would provide grants and loans to revive work opportunities in districts of chronically heavy unemployment, such as the frequently cited coal mining centers in West Virginia.

The idleness of large numbers of workers involves not only hardships for the individual and his family but also waste of the nation's human resources. If the United States is to expand its national product, we will need the help of all available hands. As President Kennedy commented in mid-March:

> I am hopeful that we can have employment high five days a week and forty hours, which is traditional in this country, and which is necessary if we are going to continue economic growth and maintain our commitments at home and abroad.

Even without the proposed new measures, the nation is already providing income on an unprecedented scale to nonworking people. For every nine dollars earned in wages and salaries, one dollar is being received under various welfare programs, mainly by persons not working. About 25 million families and individuals (less an unknown number receiving payments from more than one government source) are beneficiaries.

Plainly, government is already doing a great deal to maintain incomes and relieve the hardships of families in distress. Moreover, private business arrangements — pensions, insurance and hospitalization, severance pay, supplemental un-

employment compensation, etc. — have been expanded to form a fixed part of our over-all system of helping workers and their families meet their financial problems. The help of innumerable private charities and individuals should not be ignored; along with state and local government agencies, they still carry the main responsibility for economic and spiritual help to those in despair. They, too, know best the age-old difficulty of providing aid without undermining the will to work and sense of responsibility of the beneficiary.

Growth of Unemployment

That there are reportedly more than 5.7 million persons unemployed sounds like a severe indictment of the American economy and the ability of the private enterprise system to get more people to work. The figure is less alarming when we note that frictional unemployment is a natural phenomenon in a free market economy. The employment opportunities which a given firm has to offer depend in the final analysis on how consumers exercise their freedoms of choice. Needs for some workers are strictly seasonal, as in the garment trades, farming, food processing, resorts, retailing, and construction.

Thus, paradoxically, some level of unemployment is descriptive of a condition of what is — in the practical sense — full employment. There has been a good deal of debate as to just what this level is. Senator Paul H. Douglas, who has devoted a lifetime of study to labor statistics, wrote a book, *Economy in the National Government,* in 1952, in which he commented on Sir William Beveridge's use of 3 per cent unemployment as indicative of full employment:

> If we were to make such an application for the United States, I believe that a 3 per cent test would be almost fatal. . . . Seasonal and transitional unemployment in this country would . . . be much nearer 6 per cent than 3 per cent of the employable work force.
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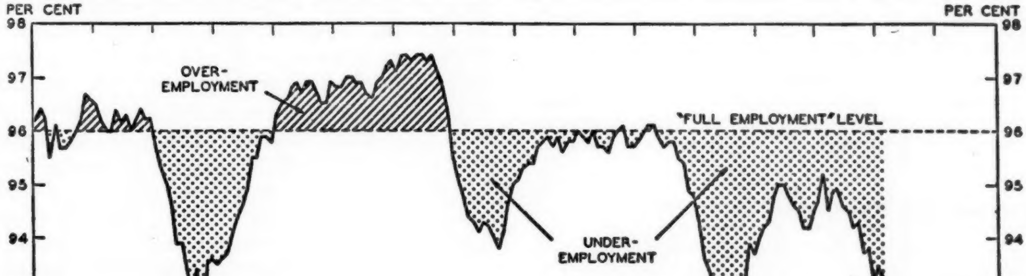
> To use deficit financing in order to drive unemployment down below 6 per cent is therefore very dangerous. It will tend to do far more harm through inflation than the good it will do by absorbing some of those who are unemployed from seasonal and transitional causes.

The more recent tendency has been to define 4 per cent unemployment as equivalent to "full employment." As Chairman Walter W. Heller of the President's Council of Economic Advisers told the Congressional Joint Economic Committee on March 6: "An unemployment rate of 4.0 per cent is taken as a reasonable target for full utilization of resources consistent with reasonable price stability." President Kennedy, at his March 15 press conference, endorsed this figure as an objective.

The 4 per cent criterion means that, with a civilian labor force averaging around 72 million persons, we might expect to have a minimum of perhaps 3 million persons unemployed at a time when work opportunities are abundant and many employers are experiencing scarcity of applicants. Thus the slack in the labor force is not 5.7 million but less than 3 million.

The chart shows the employment record going back to 1947, portraying the percentages of employment rather than of unemployment. The 96 per cent "full employment" level was reached in 1947-48, surpassed during the 1951-53 Korean War boom, and achieved most recently in the period 1955-57. During the Korean War, with 1½ million young men drawn into the armed forces, inflationary pressures were acute, as reflected in price performance and the invocation of price controls.

The failure of the economy to develop enough jobs to bring unemployment down to 4 per cent in the 1958-59 upswing has been widely deplored. A number of explanations have been offered, including excessively tight money, overspeedy rebalancing of the budget after the $12



Employment as Per Cent of the Civilian Labor Force (Seasonally Adjusted)

billion deficit in fiscal '59, constriction of the economy by failures to get on with long-promised income tax rate reforms, and profit squeeze resulting from relentless employment-cost inflation at a time when foreign competition denied opportunities for needed price adjustments. No list of reasons would be complete without mention of the long steel strike which broke the momentum of recovery at 5 per cent unemployment.

Expansion of Labor Force

Actually the economy has performed in a fairly creditable fashion in creating job opportunities. With all the talk of the unemployment problem, the Department of Labor figures show that employment in February reached a new peak for the month. In other words, the rise in unemployment is a result of growth in the labor force. In fact, the number of people more or less seriously in the market for jobs has risen at a rather spectacular rate and for reasons which the experts cannot fully explain. Nearly 2 million persons joined the labor force in the twelve months ended February 1961 — about twice the average rate of previous years — while the number of jobs increased 135,000. As a result, unemployment was 1,774,000 greater than a year earlier.

Natural forces of recovery will provide more jobs. But we need to do better and aim for a full performance of the economy consistent with the reasonable aspirations of people for leisure. The bald fact seems to be that, with the development of competitive power of industrial nations abroad, we can no longer indulge the luxury of constant employment-cost inflation. To seek a solution to the critical wage-price problem and related issues, the President has created the 21-member Advisory Committee on Labor-Management Policy, consisting of seven members drawn from business, seven from the trade unions, and five representing the public, plus Labor Secretary Goldberg and Commerce Secretary Hodges. It is to be hoped that the Committee will give close heed to the warning in the President's Economic Message of February 2:

> We cannot afford unsound wage and price movements which push up costs, weaken our international competitive position, restrict job opportunities, and jeopardize the health of our domestic economy.

Corporate Earnings in 1960

Annual reports becoming available since our preliminary tabulation last month show that the trend of corporate profits was somewhat weaker than previously indicated. Financial statements by 3,433 corporations published to date now show combined net income after taxes of $21.2 billion, a total virtually unchanged from 1959 compared with a gain of 2 per cent shown in our March compilation.

In manufacturing, where the downpull exerted by the recession became apparent toward the end of 1960, total net earnings of 2,034 companies amounted to $12.8 billion, a decline of 4 per cent instead of the 2 per cent dip shown a month ago based on 1,479 companies.

Outside of manufacturing, much of the gain reported in our earlier figures was wiped out as more minus signs appeared in trade, mining, and transportation; but public utilities and financial firms generally resisted the trend.

In manufacturing, which normally accounts for over half of corporate net earnings, almost two out of three firms reported gains in sales, but only nine out of 20 had higher earnings. The much discussed profits squeeze shows up most emphatically in the predominance of declines in earnings per dollar of sales and invested capital, reflecting rising cost pressures under competitive market conditions that forestalled corresponding price advances.

The average margins on sales in manufacturing narrowed from 5.8 to 5.4 per cent. This was one of the lowest profit margins recorded in the postwar period, and compares with the thirteen-year average (1947-59) of 6.3 per cent. Of the 41 industrial groups, average profit margins were lower in 33.

For all nonfinancial corporations included in our table, aggregate sales and revenues amounted to $307 billion. Out of this huge total, the companies retained 5.7 per cent in profits after taxes. This represented a decline from the 6.0 per cent recorded in 1959, and a sharp falloff from the 1947-59 average of 6.4 per cent.

When related to book net assets, which aggregated $232 billion at the beginning of 1960, profits of all reporting companies represented an average return of 9.1 per cent, compared with 9.8 per cent in 1959. Except for 1958, this was the lowest figure since World War II, and compares with the 1947-59 average of 11.2 per cent.

Moreover, it must be noted that rates of return figured on book net assets (also known as net worth, stockholders' equity, or capital and surplus) as a base are overstated because book values lag behind current costs. Physical property (plant, equipment, and land) is entered on balance sheets at historical costs, less accrued depreciation, and is therefore considerably below current values. Other assets, such as inventories, patents, investments, etc., may also be carried on the books below market value. While

NET INCOME OF LEADING CORPORATIONS FOR THE YEARS 1959 AND 1960
(Dollar Figures in Thousands)

No. of Cos.	Industrial Groups	Reported Net Income After Taxes 1959	Reported Net Income After Taxes 1960	Per Cent Change	Book Net Assets Jan. 1-a 1959	Book Net Assets Jan. 1-a 1960	% Return on Net Assets-a 1959	% Return on Net Assets-a 1960	% Margin on Sales-b 1959	% Margin on Sales-b 1960
16	Baking	$ 65,730	$ 68,028	+ 3	$ 573,797	$ 598,123	11.5	11.4	3.4	3.1
11	Dairy products	103,674	106,289	+ 3	878,520	952,625	11.8	11.2	2.6	2.5
15	Meat packing	71,589	58,468	—18	923,510	981,981	7.8	6.3	1.0	0.8
18	Sugar	32,675	28,729	—12	502,840	511,137	6.5	5.6	3.0	2.8
86	Other food products	382,514	392,637	+ 3	3,240,656	3,440,321	11.8	11.4	4.1	4.2
13	Soft drinks	65,251	64,844	— 1	382,405	414,839	17.1	15.6	8.3	7.2
14	Brewing	24,124	26,038	+ 8	309,470	321,003	7.8	8.1	3.4	3.3
13	Distilling	108,200	102,653	— 5	1,354,494	1,411,160	8.0	7.3	3.8	3.7
17	Tobacco products	250,090	261,133	+ 4	1,674,989	1,782,821	14.9	14.6	5.8	5.8
62	Textile products	218,159	196,528	— 8	2,680,202	2,830,282	8.0	6.9	4.2	3.5
53	Clothing and apparel	46,574	48,640	+ 4	443,406	484,043	10.5	10.0	3.6	3.5
24	Shoes, leather, etc.	50,442	43,375	—14	450,610	484,958	11.2	8.9	3.3	2.7
25	Tires, rubber products	263,657	235,651	—11	2,037,752	2,221,982	12.9	10.6	4.5	4.0
26	Lumber	145,860	107,368	—26	1,244,470	1,338,632	11.7	8.0	7.5	5.9
23	Furniture, wood products	33,019	27,655	—16	313,926	348,544	10.5	7.9	4.5	4.0
72	Paper and allied products	430,003	404,994	— 6	4,095,924	4,380,979	10.5	9.2	6.5	5.7
49	Printing and publishing	83,393	88,447	+ 6	650,833	721,288	12.8	12.3	4.3	4.7
78	Chemical products	1,138,636	1,062,989	— 7	7,720,719	8,248,714	14.7	12.9	8.9	8.0
29	Drugs and medicines	328,692	333,825	+ 2	1,495,960	1,668,064	22.0	20.0	11.6	11.1
26	Soap, cosmetics, etc.	159,929	179,049	+12	950,633	1,052,769	16.8	17.0	5.9	6.1
21	Paint and varnish	64,874	60,060	— 7	520,304	601.858	12.5	10.0	7.0	4.9
125	Petroleum prod. and refining	2,807,434	3,024,109	+ 8	28,065,660	29,632,840	10.0	10.2	8.4	8.7
22	Cement	127,175	98,428	—23	794,422	868,796	16.0	11.3	16.3	11.5
19	Glass products	203,862	181,017	—11	1,223,476	1,356,332	16.7	13.3	8.9	7.7
53	Other stone, clay products	267,789	245,801	— 8	1,834,468	2,047,477	14.6	12.0	8.9	8.1
48	Iron and steel	834,948	804,200	— 4	9,949,054	10,299,905	8.4	7.8	6.0	5.8
11	Agricultural implements	217,340	87,458	—60	1,941,196	2,087,636	11.2	4.2	5.8	2.4
90	Building, heat., plumb. equip.	147,692	128,649	—13	1,618,556	1,669,492	9.1	7.7	4.0	3.6
161	Electrical equip., radio and TV	768,248	675,619	—12	5,330,400	5,811,863	14.4	11.6	4.8	4.1
43	Hardware and tools	52,804	49,063	— 7	570,371	596,452	9.3	8.2	4.7	4.9
28	Household appliances	86,380	70,965	—18	612,567	652,872	14.1	10.9	5.8	4.5
160	Machinery	291,874	276,146	— 5	2,965,027	3,143,113	9.8	8.8	5.0	4.5
29	Office equipment	198,745	222,902	+12	1,377,103	1,574,063	14.4	14.2	6.5	6.8
52	Nonferrous metals	441,733	410,553	— 7	4,981,890	5,275,244	8.9	7.8	6.7	6.7
115	Instruments, photo goods, etc.	301,733	296,326	— 2	1,854,635	2,099,708	16.3	14.1	6.7	5.7
130	Other metal products	323,528	266,230	—18	2,843,224	3,043,390	11.4	8.7	4.4	3.6
17	Autos and trucks	1,472,195	1,508,419	+ 2	8,734,583	9,526,045	16.9	15.8	6.7	6.4
53	Automotive parts	198,649	143,527	—28	1,515,771	1,640,900	13.1	8.7	4.2	3.9
19	Railway equipment	85,132	76,090	—11	1,065,007	1,123,441	8.0	6.8	4.4	3.9
43	Aircraft and parts	193,877	138,469	—29	2,164,528	2,276,326	9.0	6.1	1.8	1.2
125	Misc. manufacturing	241,461	207,708	—14	2,021,209	2,248,525	11.9	9.2	4.7	3.9
2,034	Total manufacturing	13,324,684	12,809,074	— 4	113,908,567	121,720,488	11.7	10.5	5.8	5.4
22	Coal mining - c	75,538	69,361	— 8	995,919	1,062,989	7.6	6.5	5.1	5.6
26	Metal mining - c	53,846	59,861	+11	774,973	815,529	6.9	7.3	6.1	7.5
8	Other mining, quarrying - c	36,963	35,474	— 4	358,019	371,108	10.3	9.6	18.0	17.0
56	Total mining - c	166,347	164,696	— 1	2,128,911	2,249,626	7.8	7.3	6.5	7.5
47	Chain stores — food	229,165	236,283	+ 3	1,642,089	1,814,300	14.0	13.0	1.4	1.3
59	Chain stores — variety, etc.	160,743	139,726	—13	1,536,117	1,642,342	10.5	8.5	3.1	2.6
47	Department and specialty	202,376	191,002	— 6	1,836,180	2,021,795	11.0	9.4	2.7	2.4
7	Mail order	245,341	220,120	—10	2,011,449	2,126,523	12.2	10.4	4.3	3.8
104	Wholesale and misc.	119,610	118,451	— 1	1,041,671	1,114,729	11.5	10.6	2.2	2.1
264	Total trade	957,235	905,582	— 5	8,067,506	8,719,689	11.9	10.4	2.5	2.2
108	Class I railroads - d	578,314	444,657	—23	17,142,266	17,291,787	3.4	2.6	5.9	4.7
21	Common carrier trucking	18,960	13,468	—29	103,136	133,257	18.4	10.1	3.2	2.1
13	Shipping	37,770	35,596	— 6	676,082	694,203	5.6	5.1	4.7	5.7
13	Air transport	59,546	15,672	—74	503,464	564,955	11.8	2.8	3.4	1.0
65	Misc. transportation	60,913	57,501	— 6	732,266	761,944	8.3	7.5	4.2	3.8
220	Total transportation	755,503	566,894	—25	19,157,214	19,446,146	3.9	2.9	5.2	4.0
233	Electric power, gas, etc. - d	2,063,099	2,238,200	+ 8	20,474,096	22,039,335	10.1	10.2	13.2	13.1
33	Telephone and telegraph - d	1,262,089	1,363,853	+ 8	12,790,385	13,827,473	9.9	9.9	14.1	13.8
266	Total public utilities	3,325,188	3,602,053	+ 8	33,264,481	35,866,808	10.0	10.0	13.6	13.4
41	Amusements	43,371	53,234	+23	547,860	578,840	7.9	9.2	4.0	4.0
31	Restaurant and hotel	33,163	31,010	— 6	306,680	331,928	10.8	9.3	3.2	3.2
58	Other business services	122,903	120,080	— 2	1,102,639	1,257,271	11.1	9.6	6.3	6.8
31	Construction	46,965	44,068	— 6	365,717	392,621	12.8	11.2	4.4	3.9
161	Total services	246,402	248,392	+ 1	2,322,896	2,560,660	10.6	9.7	4.7	4.8
*	Commercial banks	1,257,000	1,686,000	+34	15,901,000	16,826,000	7.9	10.0	—	—
64	Fire and casualty insurance	260,422	239,650	— 8	3,525,696	4,106,208	7.4	5.8	—	—
220	Investment trusts - e	619,605	686,813	+11	15,672,464	18,319,822	4.0	3.7	—	—
90	Sales finance	273,846	288,710	+ 5	1,994,315	2,166,956	13.7	13.3	—	—
58	Real estate	13,374	11,103	—17	169,245	197,834	7.9	5.6	—	—
432	Total finance	2,424,247	2,912,276	+20	37,262,720	41,616,870	6.5	7.0	—	—
3,433	Grand total	$21,199,606	$21,208,967	+—†	$216,112,295	$232,180,287	9.8	9.1	6.0	5.7

a—Book net assets at the beginning of each year are based upon the excess of total balance sheet assets over liabilities; the amounts at which assets are carried on the books are far below present-day values. b—Profit margins computed for all companies publishing sales or gross income figures, which represent about nine tenths of total number of reporting companies, excluding the finance groups; includes income from investments and other sources as well as from sales. c—Net income is reported before depletion charges in some cases. d—Due to the large proportion of capital investment in the form of funded debt, rate of return on total property investment would be lower than that shown on net assets only. e—Figures in most cases exclude capital gains or losses on investments. *—Federal Reserve Board tabulation of all member banks; number of banks (6,174) not included in our totals; assets are annual averages. †—Increases or decreases of under 0.5% not shown.

the huge amounts of capital invested at rising prices since World War II have narrowed the gap between market and book values, the discrepancies are still important, especially where replacement costs have risen most steeply.

As pointed out in these pages last December, erosion of corporate profits represents an extension of a downdrift that dates back to the earliest postwar years. Certainly, if the economy is to be set on a course leading through new frontiers to new peaks of prosperity and power, this trend will need to be reversed. For profits are the creative force behind growth of job opportunities, growth of tax revenues, and growth of resources for investment in progress.

Upvaluations of Mark and Guilder

On March 4, the German Government announced that the Deutsche mark, valued at 23.8 cents (4.2 to the dollar) for the past decade, was being revalued upward by 5 per cent to 25 cents (4 to the dollar). A day later, the Netherlands Government stated that the guilder would be proportionately upvalued, from 26.3 cents (3.8 to the dollar) to 27.6 cents (3.62 to the dollar). The paralleling actions reflect the closeness of trade ties between the two countries.

In 1949, when the pound sterling and 15 other currencies were devalued by 30 per cent, the mark was one among seven other currencies cut by smaller percentages — 21 per cent. Impressions that the mark devaluation was excessive to the needs began to be formed as early as 1952. Thus there has been a recurrence of rumors that the mark would be upvalued and these became widespread last year as reserves piled up and the boom showed no sign of abating.

The German upvaluation, joined by the Dutch action, therefore, was not a total surprise, though it shook up the foreign exchange markets and, visiting unexpected losses or profits on foreign traders, spread nervousness about possible other exchange rate readjustments. There were active rumors, officially denied, that the Germans would upvalue again on the theory that 5 per cent was not enough, that the pound would be devalued against the dollar, that the Swiss franc and perhaps the Italian lira would follow suit with upvaluations. Calm was restored after further changes failed to develop and European central bank governors, meeting at the Bank for International Settlements on the March 11 weekend, issued a statement that they were satisfied that "rumors . . . about possible further currency adjustments have no foundation. . . ."

The United States Government issued a statement on the German move, describing it as "a useful but modest step" toward redressing the "basic disequilibrium in the free world balance of accounts, which has been characterized by a persistent surplus of the Federal Republic and deficits in some other free world countries, including the United States." At the same time, hopes were expressed that the action would put an end to speculation on the possibility of a further revaluation of the mark and that Germany would move forward with a large-scale program of foreign assistance to less-developed countries on a continuing budgetary basis. This last aspiration reflects the desires of the United States Government to shift some of the burdens of foreign aid over to the new Germany which has become the number one industrial power in Western Europe.

The German and Dutch Positions

The economies of both Germany and the Netherlands have enjoyed a flourishing growth over the past decade. There have been some special factors in these achievements: comparatively light burdens of expenditures for national defense and assistance to underdeveloped countries and, in the earlier postwar years, reconstruction financed under the Marshall Plan. Germany also had the advantage of labor migration from the East. But there are more ingredients than these to the success story. More than anything, German and Dutch prosperity represents the dividends from practical encouragements to individual enterprise, emancipations from controls, wise management of national financial affairs, and, above all, hard work of the people themselves.

In Germany, industrial production last year was 2½ times the level of 1950, while gross national product almost tripled over the decade. In the Netherlands, both production and GNP doubled between 1950 and 1960. Referring to the growth of the real national income of Germany, 1949-56, German Economics Minister Ludwig Erhard, in his book, *Prosperity through Competition*, observed:

> This measure of the undisputed success of the policy demonstrates how much more sensible it is to concentrate all available energies on increasing the nation's wealth rather than to squabble over the distribution of this wealth, and thus be sidetracked from the fruitful path of increasing the national income. It is considerably easier to allow everyone a larger slice out of a bigger cake than to gain anything by discussing the division of a smaller cake.

Germany has had a surplus on exports, and on current account as a whole (including U.S. military expenditures), every year since 1952. The current account surplus has averaged $1¾ billion annually since 1957. Positive encouragement to

enterprise, and willingness to use relatively high interest rates to develop saving for investment, attracted a growing influx of private capital from abroad. With a particularly steep rise in 1960, German gold and dollar holdings have passed $6 billion, more than is reported by any other foreign country. Germany has thus experienced an embarrassment of riches, tending to create excessive growth in money supply and to accentuate inflationary pressures in an already "overheated" economy.

A rising curve of government expenditures has added to the pressures. The Bundesbank in 1959 applied restrictive credit policies and, last June, went so far as to forbid payment of interest on foreign-owned deposits and sale of German Treasury paper to foreigners. But capital inflow persisted, particularly as expectations of a possible mark upvaluation spread and as Germans repatriated funds and borrowed abroad. These movements had their counterpart in strains on balances of payments of the United States and other countries.

Partly out of a sense of responsibility for maintenance of international financial order, the Bundesbank sought to counter the influx by cutting, in two stages, its discount rate from 5 per cent in November to 3½ per cent effective January 20 and by correspondingly reducing the rates on Treasury paper. But this proved insufficient.

The rise in Dutch reserves has also been impressive, having almost tripled between 1950 and 1960. The Netherlands generally has slightly larger imports than exports, but this difference is more than offset by net surpluses earned on transportation and other services.

The upvaluations will help even up competitive opportunities in world trade, as between Germany and the Netherlands and the United States and other nations. While raising the cost to the U.S. Government of maintaining military forces in Germany, the upvaluations will enlarge our export opportunities. To preserve the benefits, it will be necessary, of course, for American manufacturers to keep a lid on their costs and prices.

Domestic Considerations

The decisions of the two governments, however, were primarily dictated by their own domestic situations with prosperity spilling over into inflationary boom.

The idea of upvaluations was resisted, not unnaturally, by German and Dutch exporters. But these objections were outweighed by the difficulties of holding inflationary forces in check. In other words, it was decided that German and Dutch business could stand some stiffening of foreign competition. The upvaluations have the natural effect of holding down prices expressed in marks and guilders. They also permit further easing of credit policies.

Two other alternatives presented themselves. One would have been a further easing of restraints on imports, so far as consistent with the Common Market obligations of the two countries. This course is being followed by France, which is lowering tariffs unilaterally by 5 or 10 per cent to arrest a rising price trend. In Germany, there apparently was some discussion of removing the special import tax and repealing tax remission on exports.

The other alternative would have been to let inflation effect the cure, with costs and prices rising relative to those of other nations. Indexes of the cost of living in both Germany and the Netherlands, after rising about 4 per cent in 1959, held steady in 1960 but labor shortages, showing up in wage advances of around 10 per cent a year, have been setting the base for further price markups. The simple fact was that this trend of events was unacceptable to the people, fully aware of the follies and futilities of wage-price inflation. Basically, thus, the decisions were impelled by desires for stable money. Revaluation against other currencies — the dollar, the pound, the Swiss, French and Belgian francs, indeed all other currencies in the world—seemed the best way out, to relieve excess pressures of demand for home-produced goods and to make imports more cheaply available.

The Dollar Standard

The German and Dutch actions stirred widespread interest if only because upvaluations against the dollar have been so uncommon. Among European currencies, only the Swiss franc has held a firm relationship to the U.S. dollar throughout the postwar period. Since World War II, there have been a hundred devaluations of foreign currencies in terms of the U.S. dollar, but only three previous upvaluations. In 1946 the Swedish krona was upvalued from 23.8 to 27.8 cents, though later, in 1949, it was cut back to 19.3 cents. In 1948 the New Zealand pound was upvalued from $3.22 to $4.03 (equivalent to the pound sterling) but devalued to $2.80, in company with sterling, in 1949. The Canadian dollar was upvalued from 90.9 cents back to parity with the U.S. dollar in 1946, but cut back again to 90.9 cents in 1949. The present "floating rate" exchange system was introduced on September 30, 1950. Since 1952, as a result of Canada's attractions to foreign investors, the Canadian dollar has commanded a premium over the U.S. dollar, rising as high as $1.06 over the period

1957-59 but hovering closer to $1.01 in recent months.

Some observers described the German and Dutch actions as a devaluation of the dollar, and certainly any sequence of similar actions by other countries would reflect a weakening of faith in the dollar as an international standard of value. But this has not happened, nor is it likely to so long as American fiscal and credit policies are pursued along the lines which the rest of the world considers sound.

Other countries have the power to upvalue or devalue their currencies against the U.S. dollar. The United States Government does not possess an equivalent ability to upvalue or devalue against other currencies. This is a cost of having a dollar which serves as an international unit of value. Other countries price their currencies with respect to the dollar or, as in the Canadian case, allow their currencies to fluctuate against the standard of the U.S. dollar. We could, to be sure, undermine foreign confidence to such a degree as to precipitate widespread upvaluations of other currencies. But this would be an incredible act on our part – one of shrugging off international leadership and responsibility.

Actually, we can take a good deal of satisfaction out of the achieved stability of exchange rates. There were fewer changes in relationships among major currencies during the period September 1949 to February 1961 than in any corresponding time span since World War I. The adjustments of September 1949 worked out better than anyone reasonably could have hoped and set a basis for gradual dismantling of exchange controls, at least over current transactions. The test now is for nations to make a free currency system work and to keep their finances on an even keel. Even so, some minor adjustments may be needed from time to time.

Foreign Currency Values*
Expressed in U.S. Cents

	May 31 1946	Aug. 31 1949	Sept. 30 1949	Feb. 28 1961	Mar. 15 1961
Pound sterling	403.0	403.0	280.0	280.0	280.0
Canadian dollar	90.9	100.0	90.9	101.3	101.2
100 Japanese yen	†	27.8	27.8	27.8	27.8
Dutch guilder	37.7	37.7	26.3	26.3	27.6
Deutsche mark	†	30.0	23.8	23.8	25.0
Swiss franc	22.9	22.9	22.9	22.9	22.9
100 old French francs‡	84.0	86.8	28.6	20.3	20.3
Belgian franc	2.3	2.3	2.0	2.0	2.0
100 Italian lire	44.4	17.4	16.0	16.0	16.0

*Mainly official rates, but "floating" rate in Canada for 1961, effective export rate in France for August 1949, and "premium" rate in Italy for 1946. †No definite exchange rate after the war until June 1948 in Germany and April 1949 in Japan. ‡Equals one new franc.

A Touchy Problem

Realignments among the values of important currencies are upsetting to the commercial world even when, as in the German and Dutch cases, the changes amount to no more than 5 per cent. As shown in this case, they permit speculators to reap a reward and start new speculations and disturbing flows of "hot money." Yet there sometimes have to be adjustments in international currency relationships, to compensate for basic structural changes in international trade, differences in rates of progress in productivity, and spasmodic indulgences of inflation in one country or another.

The world is equipped with an International Monetary Fund to help nations ride out temporary swings in their balances of payments. But where a particular country has a chronic problem of either excessive surpluses or deficits in its balance of payments, temporary measures help only if there is simultaneously an effective attack on the problem.

There is a choice of ways to deal with this kind of situation. One is by adjustment of the economy to a higher or lower price level – by tolerated inflation or determined retrenchment. A second is by change in exchange rate. A third is by interference with the free market – by exchange and import controls.

The first type of adjustment – the classical cure – has the great merit of preserving order and stability in international currency relationships, with all the resulting benefits in trade and investment. Sometimes, however, this choice is not practicable, economically and politically. Retrenchment may involve unemployment and bankruptcies; inflation, once tolerated, gains a momentum that is hard to check. Modest measures, operating with only marginal effect, will frequently suffice, but this is not always so. When solution in these terms is impracticable the other means have to be explored.

The second choice – change in exchange rate – attempts to meet these objections while maintaining freedom of trade, travel, and capital movements. If exchange rates cannot be adjusted, then the tendency is to use exchange controls to prevent money from going out or to keep it from coming in. The end result then may be to suffocate the flow of trade which it is the function of foreign exchange rates and foreign exchange markets to accommodate. In these special cases, fixed exchange rates defeat their purpose.

Some advocates of liberalism in the old sense have gone so far as to suggest that all currencies be allowed to float so that a country's overseas payments and receipts could always be cleared whichever way the pressures were running. What this in effect would mean is that other currencies would rise and fall against the dollar from day to day and even from hour to

hour. The Canadian system offers an example where the authorities intervene in the market only to smooth out movements in the exchange rate dictated by forces of supply and demand. Although there are no statutory limits on the movement of the Canadian dollar, the range over the past five years has been from $1.00 to $1.06.

Individual countries may, for special reasons, wish to let their currencies float – against the fixed reference points of other currency values. But trying to have all currencies float would be to create indescribable confusion in world trade as well as to put all currencies at the mercy of speculative bull or bear raids. International transactions are complicated enough without taking away common denominators.

The rules of the International Monetary Fund require that each currency have a fixed parity and that treasuries and central banks limit exchange rate fluctuations to 1 per cent on either side of the official parity. The IMF, while upholding the rule in principle, has tolerated the Canadian floating rate system for 10 years now, and there are a dozen countries that, for one reason or another, have not officially established parity values for their currencies. Some students of the problem have urged a widening of margins of exchange trading. This could give the exchange markets a better chance to clear transactions, discourage international movements of funds simply to take advantage of interest rate differentials, let a strong or weak currency demonstrate more fully how strong or weak it is, remove altogether perhaps some needs to adjust par values, and make needed adjustments of par values more orderly.

The IMF might give consideration to these proposals. But the principle that there should be parity values, and prescribed limits to exchange rate fluctuations, should be preserved.

Tax Paradise Revisited

In the January issue of this *Letter* we published an article, "Agenda for Tax Reform," which took account of complaints over the sluggish growth of the U.S. economy and suggested that we might find the reason in the severity of our taxation on the means to progress – employment, income, and capital accumulation. Other nations are getting ahead faster with tax systems designed to protect incentives to individual effort and enterprise.

The article offered a series of comparisons of our federal income tax rates with those imposed by central governments in other countries. Tables were presented showing that the United States, in a list of 20 countries, had the highest marginal rate of personal income taxation (91 per cent) and, in a list of 14 countries, the highest maximum tax rate (52 per cent) on undistributed corporate profits. A third table brought out the fact that, among nations with high corporate tax rates, other countries go much further in giving credit to shareholders for these taxes, thus mitigating double taxation of corporate profits distributed as dividends. The article also mentioned the more generous capital consumption allowances permitted in Western Europe as well as the absence of capital gains taxation in many countries abroad.

We had expected our article to bring letters from readers abroad, throwing further light on their statutes and tax systems. International comparisons of taxes are tricky, and not only in the ways the laws are written but in the ways they are administered. Words even take on special meanings for tax purposes. Nevertheless, the subject is one that demands study. The power to tax is the power to destroy. As Germany and Japan can attest, it can also be applied as a power to create.

Personal Income Taxation

Our analysis was explicitly limited to *income* taxation by *central governments.* Letters from Zurich properly complain that our tables made Switzerland look too much like a tax paradise, with 8 per cent as the maximum marginal rate of personal income tax imposed on Swiss citizens by the Confederation. This figure was affirmed as correct but it was pointed out that cantonal (state) and communal (local) income taxes – highly variable from one place to another – build up the maximum marginal rate of personal income tax to more like 20 or 30 per cent in Zurich and some other areas.

This still seems moderate to an American citizen who has 20 per cent as the *initial* rather than the *top* personal income tax rate. The reason becomes clear why a famous boxer found Swiss citizenship attractive.

A Norwegian correspondent, Mr. Knut Rasmussen of the Norwegian Shipowners' Association, draws attention to the fact that Norway, like Switzerland, is a country which relies on a high degree of local taxation. Here the situation differs fundamentally from the Swiss case because municipal income taxes (inapplicable to dividends), ranging in some Norwegian towns as high as 22 per cent, are superimposed upon central government levies running up to a top of 55 per cent. Even so, it is worthy of special note that the United States, and the United

Kingdom too, are more determined to level down people of superior talents and earning power than socialist Norway. Or, perhaps it is that Norwegians are more practical and recognize that confiscatory rates are less productive of revenue than they are of tax avoidance.

Taxing incomes has become the favorite method of raising government revenue in the United States. Income taxes are the main revenue source of the Federal Government and are now growing in importance among states and even municipalities. The following table, largely based on data supplied by the Tax Foundation, lists the 32 states which now levy income taxes. The Foundation also lists some 300 municipalities which have local income taxes, led by Philadelphia which this January advanced its rate from 1½ to 1⅝ per cent. There is no state income tax in Pennsylvania, where most of the municipalities taxing income are located, but we now have cases in Kentucky and Missouri where triple-tiered income taxation is in effect.

Maximum (Marginal) Rates of Personal Income Taxation Imposed by States in the U.S.A.

Alaska	12.18%	Kentucky	6.00%
Minnesota	11.55*	Louisiana	6.00
North Dakota	11.00	Oklahoma	6.00
Wisconsin	10.20†	Kansas	5.50
New York	10.00	Mississippi	5.50
Idaho	9.50	West Virginia	5.22§
Oregon	9.50	Alabama	5.00
Colorado	9.00‡	Arkansas	5.00
Hawaii	9.00	Utah	5.00
Delaware	8.00	Virginia	5.00
Vermont	7.50	Arizona	4.50
California	7.00	Missouri	4.00
Montana	7.00	New Mexico	4.00
North Carolina	7.00	Iowa	3.75
South Carolina	7.00	Maryland	3.00‖
Georgia	6.00	Massachusetts	3.00¶

*Includes 10% surtax on 1960 income. †Includes 20% surtax on 1960 income. ‡Additional surtax of 2% on dividend and interest income. §Adopted February 14, 1961. ‖Except 5% on net investment income. ¶Includes 1% additional tax and 20% surtax on 1960 income.

Note: Income from investments is taxed by New Hampshire (4.25%) and Tennessee (6.00%). The District of Columbia has an income tax with a top rate of 5%.

Theoretically, an American can have all of an increment of income taken away from him in taxes but this contingency can be avoided with timely advice from tax counsel.

Capital Taxes

The focus of our January article was on income tax rates. Except by passing allusion to gift, inheritance, and capital gains taxes, we did not attempt to get into the thorny subject of capital taxes. According to a Bulletin of Julius Bär & Company, Zurich, sent to us by courtesy of Mr. Walter J. Bär:

> . . . the Swiss stockholder faces a plurality of taxes. In the first place, the dividend income is reduced at source by the Federal stamp duty on coupons in the amount of 3 per cent. . . . The dividend is then subject to cantonal and communal income tax and to the federal tax. Furthermore, the cantons and communes levy assets taxes on stock holdings and, to conclude, the church tax is deducted of which the amount varies from one canton and one creed to the other.

Capital taxes in Switzerland have become more severe with the rise in Swiss stock prices and the decline in their yields – indeed to a point where capital taxes may exceed the dividend return since these taxes are levied on market values without regard to income:

> The purchase of such shares, which fetch almost no yield or for which an extra amount must be paid in terms of taxes, is therefore not interesting for the permanent investor. Socially, this is undesirable because acquisition of foreign securities, speculation and tax evasion are thus promoted. Many Swiss stockholders gradually come to face the problem of whether they, too, should become "tax tourists" and establish their tax residence in Liechtenstein or Monaco!

In the Scandinavian countries, too, capital taxes bear down on persons with accumulated wealth. In Norway, for example, the capital tax is a net worth tax with assets valued at the market. The tax rates graduate up to 1.75 per cent on the national level and the municipality takes about 0.4 per cent.

Mercifully, the Scandinavian countries put an 80 per cent limit on the national and municipal income and capital taxes. In the United States the federal income tax has a limit, but at a higher level, 87 per cent.

Equivalents for capital taxes are not missing from the American scene. Inheritance, gift, and capital gains taxes are forms of levies on accumulated capital; in the same broad category are real estate taxes, universally applied, and also personal property taxes in the states which levy imposts of this type. Florida, for example, favored by retired people not only for its climate but also for its forbearance from state income taxation, imposes an 0.2 per cent personal property tax applicable to the "full cash value" of stocks and bonds. Property taxes can create situations like those cited for Switzerland where the tax costs of carrying an investment exceed the direct return.

It is worthy of passing note that corporations in Europe are often subject to taxation by state and local as well as central governmental bodies. In the United States, corporations are subject to state taxes under a wide variety of formulae as the price of doing business in the corporate form. The highest state income tax levied on corporations is Idaho's 9½ per cent. Moreover, a corporation may be liable for taxes in several states.

Japanese Tax Reduction

Letters from readers overseas so far have exposed only one real error in the figures published in our article. A Japanese official explains that their "enterprise tax" is a local government tax and should not have been added onto the central government's 38 per cent corporate tax. Thus the table on maximum tax rates imposed by central governments on undistributed corporate profits should have shown Japan at 38 per cent instead of the 45.44 per cent published in our table. Correspondingly, the maximum rate paid and withheld on corporate profits distributed as dividends should have been shown as 44.2 per cent (allowing for a 10 per cent withholding tax) instead of 50.9 per cent, and the credit allowed the individual shareholder in a range of 20-30 per cent (including credit for tax withheld) instead of 30 per cent. A new Japanese tax law will reduce the tax credit on dividends received, effective January 1, 1962, to 17½-25 per cent. But this change is more than compensated for by a cut in the corporate tax rate effective April 1, 1961. The two tables on taxation of corporate profits are reproduced here with Japan shown in its right place based on the new law.

Summary

In summary, it would appear that compounding of income taxes is more serious in a number of countries abroad than it is in the United States. But even when account is taken of all levels of taxation, our statement seems to hold that the United States can lay claim to the highest personal income tax rate in the world. This is a curious position for a country that relies on individual initiative for progress.

Taxes on capital add to effective total tax burdens in Switzerland as well as the Scandinavian countries. These taxes amount to a special impost on wealth. The trouble with them is that, like excessive income tax rates, they drive wealth away into friendlier tax jurisdictions.

Taxation by Central Governments of Corporate Profits Distributed as Dividends

	Maximum rate paid and withheld by corporation	Credit allowed individual shareholder
France	62%	24%*†
Netherlands	54.95	15†
United States	52	4
United Kingdom	51.25	38.75‡
Canada	50	20
Belgium	45.31	30†
Germany	42.58§	25†
Sweden	40	0
Australia	40	0
Switzerland	35.60	27†
Japan	35.20	17.5-25
Norway	30	0
Union of South Africa	25	33.33-100
Italy	20	8

*Credit is 8% against taxable income and 16% against personal tax liability. †Deducted at source and credited to individual shareholder. ‡The individual, if subject to surtax rates on his personal income tax return, must, however, pay the surtax on the gross dividend actually declared rather than the net dividend actually received. §Ignoring the variable effect on the tax base of property tax on net worth.

Maximum Tax Rates Imposed by Central Governments on Undistributed Corporate Profits

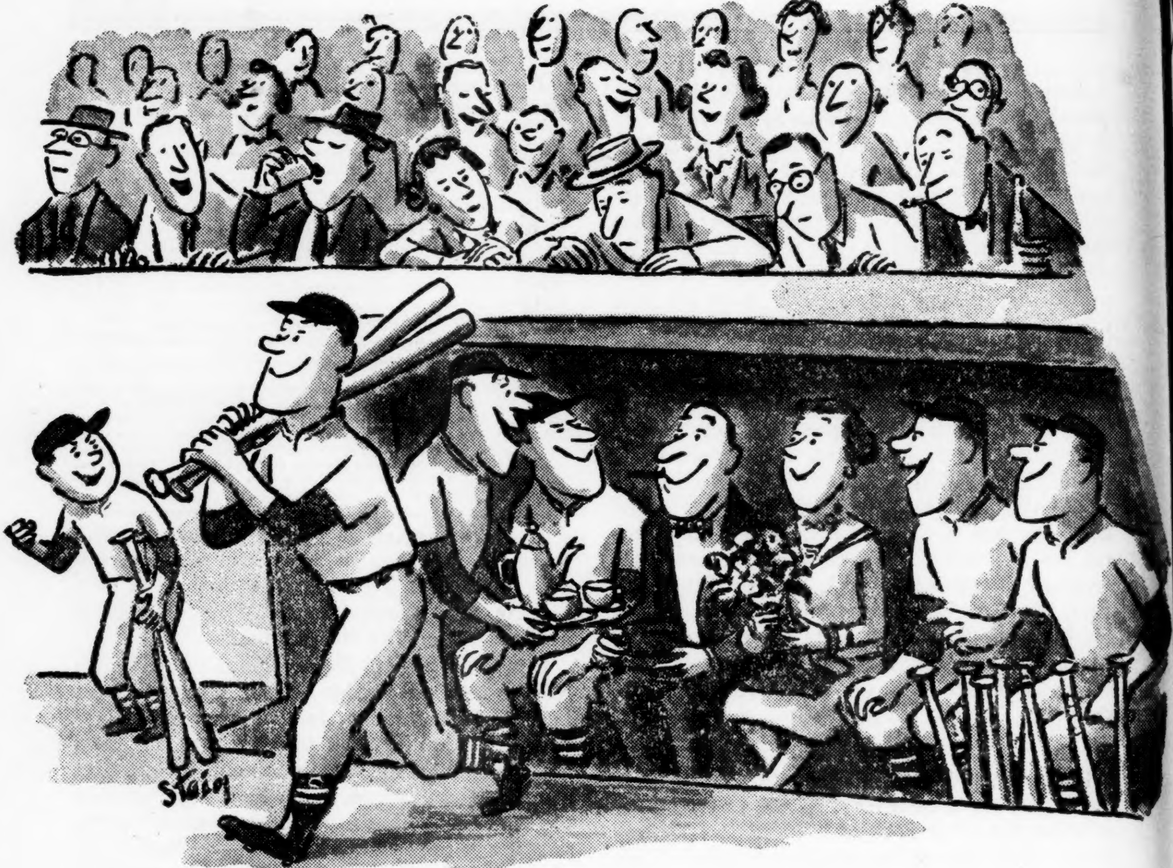
United States	52%
United Kingdom	51.25
Germany	51
France	50.98*
Canada	50†
Netherlands	47
Belgium	40§
Australia	40
Sweden	40
Japan	38‡
Norway	34
Union of South Africa	25‖
Italy	20¶
Switzerland	8§

*Includes tax levied on reserves of accumulated profits. †Includes 3% tax for old age security contribution. ‡There is an additional 10% tax on retained profits of closely held corporations. §Taxes paid in previous year are deductible in determining taxable income, thus lowering the effective burden. ‖An extra 25% tax is levied on profits (beyond certain limits) not distributed. ¶In addition, there is a 15% tax on profits in excess of 6% of capital and reserves.

One other general observation is that tax rates tend to be more flexible abroad. Here, we have become locked into a federal income tax rate structure adopted back in 1954. Abroad, rates are commonly subject to annual review and changes. For example, it has been reported that the Netherlands has in readiness a set of tax reductions to put in force when stimulation of employment opportunities is needed. This very state of alertness gives a coloration of optimism to the business community. It might be added that, among nations forging ahead in the competitive world, tax changes have been predominantly in a downward direction with the fiscal result that growth of the tax base has bolstered revenues.

It would be helpful if we could learn some lessons from abroad, and set the stage for a period of brilliant expansion by adopting a policy of shaving income tax rates year after year and thus raising the horizons for individual and collective progress. Such an imaginative formula is offered in the Herlong-Baker bill now before Congress for consideration. As Congressman Herlong has said so well:

> By use of capital-destroying tax rates and methods we have prevented our economy from achieving anything like its potential for progress. This means that we have fewer and less productive jobs than should be available. Our total production is far short of our national capability for progress and the standard of living of our people is correspondingly less than it should be. It also means that failure to effect fundamental reform of our tax structure quickly would put in jeopardy the industrial supremacy on which our national security depends.



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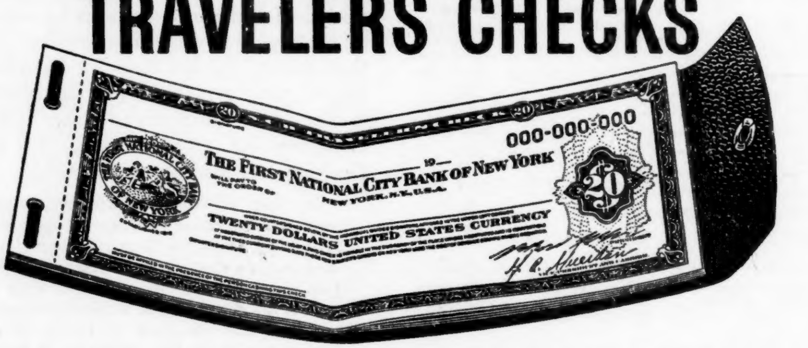

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